Question for the Record
Response of
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Additional Questions for the Record

The Honorable Lee Terry

1. **In 1975 and 1980, this Committee placed safeguards on the FTC's authority following a number of large and significant rules the agency issued in the 1970's, including a very controversial rule to regulate children's advertising. These rules have been in place for about 35 years in order to ensure the Commission can promulgate the best rules possible for all businesses and consumers. Congress acted in part because the FTC (unlike some other agencies that have narrower jurisdiction) has vast authority to identify and sanction unfair and deceptive acts or practices across nearly every sector of the economy, and it doesn't focus on specific industry technology or practices. In fact, former FTC Chairman Kovacic has said that "no regulatory agency in the United States matches the breadth and economic reach of the Commission's mandates."**

   a. **Do you think the FTC has been effective in protecting consumers during the 35-plus years since the FTC Act was amended and changed the procedures for their rule writing authority?**

   The FTC has simply sidestepped the procedural safeguards Congress imposed on its rulemaking powers through Magnuson-Moss. Instead, the FTC engages in *de facto rulemaking* through a combination of case-by-case enforcement through consent decrees (and therefore effectively outside the judicial system) and informal guidance, particularly reports issued after workshops, that have the effect of law — with none of the safeguards of formal rulemaking. This has allowed the FTC to create informal law on a wide variety of issues grounded, often tenuously, in its unfair or deceptive acts or practices ("UDAP") authority and, to a lesser degree, its unfair methods of competition ("UMC") power — while offering regulated companies little guidance on how to comply with the law. This raises significant due process concerns and the more fundamental question: are the substantive constraints volunteered by the FTC in its 1980 Unfairness Policy Statement and 1983 Deception Policy Statement still meaningful constraints upon the FTC's discretion? Or, by slipping the bonds of the FTC's procedural authority, has the FTC essentially also escaped these substantive limitations?

   b. **Do you agree that, as current law requires, the FTC should ensure that its rules are narrowly tailored, based on sufficient information, and able to withstand appropriate judicial review?**

Certainly — for both formal and *de facto* rules. The FTC's Magnuson-Moss rulemaking procedures are designed to ensure that formal rules issued under Section 5 are narrowly tailored to clear problems in ways that satisfy the cost-benefit analysis inherent in Section 5(n)'s unfairness standard and the analysis of materiality (a proxy for harm and, thus, cost-benefit) inherent in Section 5's deception standard. The FTC has essentially leveraged its costly investigative process, its cumbersome Part III adjudication process and its enormous bully pulpit (capable of inflicting serious public relations harm) to coerce companies to agree to settlements and consent decrees — rather than litigate in court.

The FTC should use its formal Magnuson-Moss rulemaking powers more often, but where it does not do so, it should change its approach to case-by-case enforcement to achieve the same essential goal of Magnuson-Moss: rigorously applying the requirements of Section 5. On the one hand, the FTC should evaluate and revise its own procedures in order to make these disputes more likely to be litigated in federal courts, so as to ensure appropriate judicial review and build a proper record for regulated parties to rely upon going forward. On the other hand, where litigation does not occur, the FTC should do more to explain its analysis of the requirements of Section 5 in each case it settles, and in a systematic way through doctrinal guidelines similar to those the FTC and Department of Justice issue to summarize the development of antitrust law. As with the Merger Guidelines, Section 5 guidelines should be grounded as much as possible in law and economics.

2. **Here are some of the differences between the FTC Act and the "notice-and-comment" rulemaking that is undertaken by some other agencies.**

   - ***Prevalence*: The FTC must identify a pattern of activity — a prevalence, as opposed to one instance — before engaging in a rulemaking. There is no similar requirement in notice-and-comment rulemaking.**

   - ***Disputed issues.* If the FTC concludes that there is a disputed issue of material fact in a rulemaking, the agency must permit cross-examination of witnesses in a pre-rulemaking hearing and afford the right to offer rebuttal comment. That gives all parties the opportunity to participate. Those requirements don't apply to notice-and-comment rulemaking.**

   - ***Economic effect.* When the FTC issues a rule, it is required to provide "a statement as to the economic effect of the rule, taking into account the effect on small business and consumers." That seems eminently reasonable to me, yet it is not required by notice-and-comment rulemaking.**

Do you agree that these are good protections both for consumers and businesses?

The particular restraints on FTC rulemaking are certainly good protections both for consumers and businesses. While the FTC and its advocates argue that these protections hamstring the agency and make it impossible for it to promulgate rules, there are good

reasons for these procedural safeguards. The FTC's rulemaking spree had reached such a height that, by 1978, the Washington Post dubbed the FTC the "National Nanny" — over its attempts to ban advertisements of high-sugar food products to children.[1] This, and a variety of other regulatory pushes, led a heavily Democratic Congress to enact Magnuson-Moss — and demand that the FTC constrain its substantive authority through its 1980 Unfairness Policy Statement. Despite these procedural safeguards, the FTC is again stretching the bounds of its authority today in a way that largely avoids them, which is troubling.

3. **It appears to me that those who argue for the FTC to have general notice-and-comment rulemaking authority under the APA must believe that the FTC does not possess sufficient authority today to identify, penalize and prevent bad actors from taking actions detrimental to consumers. Yet we've heard testimony today and in the past repeatedly about how effective the FTC is, so that doesn't seem consistent. What are your thoughts here?**

   The FTC can be an effective regulator by using its case-by-case enforcement authority under Section 5. But, unfortunately, it has repeatedly abused that process. Often the successes it points to in enforcements could also be seen as examples of bad process. For example, the unbroken streak of settlements in Section 5 data security cases until *FTC v. Wyndham* could be because the FTC was on sound legal ground in every single case — but it could testify to the defects in what some FTC Commissioners have taken to calling a "common law of consent decrees," notably that a lack of predictability may make companies reluctant to litigate even when the FTC is *not* carefully grounding its legal claims in Section 5.

   Before Congress considers any revision to Magnuson-Moss, or any new major new grants of standard APA rulemaking authority over specific issues (e.g., cyber-security), Congress should insist that the FTC: (1) make a good faith effort to actually conduct a Magnuson-Moss rulemaking and (2) change its approach to policymaking through enforcement by issuing more guidance, pursuing more litigation in federal courts, examining the institutional structure that makes litigation so unlikely, and being more explicit about its economic analyses in *all* its actions.

4. **In some specific areas, the Congress has given the FTC targeted authority to use notice-and-comment rulemaking. Some of these instances include the Telemarketing and Consumer Fraud and Abuse Prevention Act (1994), the Children's On-Line Privacy rulemaking required in 1998, and the Gramm-Leach-Bliley Act (1999) regarding financial institutions and consumer privacy. This "case-by-case" approach to notice-and-comment rulemaking ensures that, where it is needed, the FTC can address a specific issue in the manner that Congress has determined.**

   a. **Do you agree that these specific directions from Congress have been working well?**

[1] http://techfreedom.org/post/92723075484/thanks-ftc-but-we-dont-need-a-national-nanny

Yes, generally speaking the specific directions Congress has given to the FTC regarding financial institutions and consumer privacy seem to have been working well. Those specific directions resulted in expedited rulemakings that produced targeted regulatory frameworks that typically adequately addressed the underlying problems. Some might say that the FTC needs greater free reign to address those problems as they arise, without having to wait for specific direction from Congress, but history shows both that (1) the FTC has at times abused such general discretion, and (2) Congress is able to react timely to address serious harms as they arise — such as with threats to the online privacy protection of children — so this current system of delegating specific authority to the FTC when appropriate seems to be working well.

b. Would you agree with former FTC Chairman Kovacic when he stated that this is the best approach to FTC rulemaking, given the broad subject matter authority and economic effects that FTC decisions can have across the economy?

When Congress wants the FTC to have an expedited notice-and-comment rulemaking, it can craft a narrow grant of APA rulemaking authority that gives FTC discretion but limited, appropriately, to the targeted harm at issue. As Chairman Kovacic argued at this hearing, there giving the FTC standard rulemaking authority across the board would be unwise: given the breadth of the FTC's jurisdiction and vagueness of its authority, the FTC could regulate just about every aspect of economic activity in the U.S. This is not a theoretical risk; it is precisely what the FTC began trying to do in the 1970s — from pollution to labor practices and beyond.[2] Such actions might well extend into tenuous and sensitive areas where Congress never intended it to regulate, and might also have wide-reaching and deleterious effects upon the national economy. For those reasons, former FTC Chairman Kovacic is correct in his assessment that giving the FTC specific grants of APA rulemaking authority over specific issues to address real problems is the best approach to FTC rulemaking.

5. Today the Federal Trade Commission has jurisdiction over a wide-range of high-tech markets, including computer hardware and software, online search engines, and audience measurement services. What are some of the challenges the agency faces in applying its competition and consumer protection authority to such rapidly changing markets?

Inherent limitations on anyone's knowledge about the future nature of technology, business and social norms caution skepticism about regulators' ability to predict whether any given business conduct will, on net, improve or harm consumer welfare. In fact, a host of factors suggests that even the best-intentioned regulators may tend toward overconfidence and the erroneous condemnation of novel conduct that benefits consumers in ways that are difficult for regulators to perceive or understand.

[2] http://www.ftc.gov/public-statements/2003/05/ftcs-use-unfairness-authority-its-rise-fall-and-resurrection - N_15

Nobel Prize winning economist Ronald Coase lamented that industrial organization is still not well understood — and this remains true.[3] Transaction costs help explain why companies choose to internalize operations within the firm, rather buying them on the market. Sometimes it is cheaper for a firm to go buy what it needs on the market. Other times, it is easier for a firm to vertically integrate and build the components of production. Firms exhibit a lot of variation answering the "make or buy" question. Regulators often misunderstand why businesses make the choices they do, though, and attribute anti-competitive or anti-consumer intent to what Coase called "ununderstandable" business practices.[4]

Business generally succeeds by trial-and-error more than by theoretical insights or predictive power, and over-regulation thus risks impairing experimentation, which is an essential driver of economic progress. As a consequence, doing nothing may sometimes be the best policy for regulators, and constraints upon regulatory discretion to act can greatly benefit consumers by reducing the likelihood that regulators will proscribe ununderstandable conduct that turns out to be pro-consumer.

One thing is certain: a top down, administrative model of regulation is ill-suited for rapidly changing technologies. The technocratic mindset, which presumes that regulation is simply a kind of social engineering, is inconsistent with the regulatory humility required in the face of fast-changing, unexpected — and immeasurably valuable — technological advance. As Virginia Postrel put it:

> Technocrats are "for the future," but only if someone is in charge of making it turn out according to plan. They greet every new idea with a "yes, but," followed by legislation, regulation, and litigation.... By design, technocrats pick winners, establish standards, and impose a single set of values on the future.[5]

6. In response to calls from members of Congress and her fellow Commissioners for formal guidelines on what constitutes an "unfair method of competition" under Section 5 of the FTC Act, Chairwoman Ramirez has said that guidelines are unnecessary because sufficient guidance already exists in the form of the Commission's settlement agreements. Do you believe the FTC's settlement agreements provide sufficient guidance about what conduct the agency will prosecute under its Section 5 authority?

No. The FTC's complaints and settlement agreements fail to provide enforceable precedents or adequate guidance — either as a policy matter or a constitutional matter. For instance, the FTC brings data security cases (under both UDAP and UMC) based on the alleged "unreasonableness" of a respondent's security practices. But it does so without addressing

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[3] R.H. Coase, *Industrial Organization: A Proposal for Research*, in ECONOMIC RESEARCH: RETROSPECT AND PROSPECT, 59 (Victor R. Fuchs, ed. 1972), *available at* www.nber.org/chapters/c7618.pdf ("Very little work is done on the subject of industrial organization at the present time, as I see the subject[.]").

[4] *Id.* at 67.

[5] THE FUTURE AND ITS ENEMIES: THE GROWING CONFLICT OVER CREATIVITY, ENTERPRISE, AND PROGRESS, 48 (1998).

the actual Section 5 elements (materiality, substantial injury, etc.) and even without connecting them to the unreasonableness standard that the FTC claims to employ in lieu of the statutory language. Most of these complaints are so conclusory and threadbare that they would likely fail to withstand a 12(b)(6) motion to dismiss for failure to state a claim under *Twombly*.

Despite the hopes of the FTC's defenders, the FTC's complaints and consent decrees do not amount to a "common law" at all. A recent study by Geoffrey Manne and Ben Sperry, presented at a George Mason Law and Economics Center symposium, suggests that the FTC's complaints on data security, for instance, are pro forma and cursory, exhibiting none of the detailed factual analysis and doctrinal evolution that is the great virtue of the common law.[6] The typical FTC complaint is only three pages long and cites no precedent (mainly because there *is* no precedent). Indeed, few FTC complaints even allege or quantify actual harm to consumers, instead relying on vague assertions of loss (which are often borne entirely, or almost entirely, by credit card companies — not consumers — anyway). At the same time, the consent decrees impose almost identical remedies irrespective of the cases' widely varying facts, with 20-year oversight and imposition of a set of data-security policies derived nearly verbatim from financial services regulations, regardless of the industry involved in the breach. This regulation-by-complaint system — uniformly offered with the barest of legal analysis— has left companies with almost no guidance on what data-security practices the FTC Act supposedly prohibits or requires. Instead, the FTC has adopted an essentially standardless, ad hoc approach to data security. Such a lack of guidance could even violate judicial requirements that agencies must, to satisfy constitutional standards of due process, provide "fair notice" of their policies.

7. (For Geoffrey Manne and/or Daniel Crane) Commissioner Wright has called on the FTC to issue a policy statement explaining the boundaries of the agency's authority to prosecute "unfair methods of competition." In his view, federal antitrust enforcement should not be a "game of gotcha," and businesses need to be able to distinguish between conduct that is lawful and conduct that is unlawful under Section 5. Do you agree that formal UMC guidance is important, and if so, why? Are there any reasons why the Commission should not issue such guidance?

Commissioner Wright is right in saying that formal UMC guidance is important, and that the FTC should use its institutional expertise to develop and issue such guidance. As he put it, "In order for enforcement of its unfair methods of competition authority to promote consistently the Commission's mission of protecting competition, the Commission must articulate a clear framework for its application."[7] A regulatory "game of gotcha" is indeed an

[6] *See* Manne, et al., *Gap-Filler or Over-Regulator?: An Empirical Analysis of the FTC's "Common Law" of Data Security* (working paper delivered at the LEC Public Policy Conference on "The Future of Privacy and Data Security Regulation") (2014).

[7] Statement of Commissioner Joshua D. Wright, *Proposed Policy Statement Regarding Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act* (June 19, 2013),

apt description of how the FTC has proceeded in recent years under its UMC authority, and Commissioner Wright's proposed policy statement is an admirable step towards developing a clear outline for the FTC's UMC authority. However, further collaboration and deliberation are needed for any potential framework to strike the right balance going forward.

In drafting Section 5, Congress intentionally left it in general terms, because more specific terms would likely become soon obsolete or subject to simple workarounds by regulated parties. To some extent, the same concerns are present in developing any formal guidance under the FTC's UMC authority (or its UDAP authority), in that formal guidelines appropriate and comprehensive today might soon prove to be useless (because parties find easy ways to work around them) or even harmful (if they hamstring the agency's ability to address novel conduct that is in fact detrimental to consumer welfare) in the future. However, revising and updating standards as needed is easier for the FTC to do than for Congress, so those concerns are not as acute in the administrative context, and they should not keep the FTC from trying to develop such guidance. More importantly, if "guidelines" prove fragile, it is probably because they are overly detailed and prescriptive. The more closely guidelines amount to *de facto* regulations, the more likely they will be to become obsolete quickly (in addition to raising serious administrative law problems about circumvention of procedural safeguards for rulemaking, whether under the APA or Magnuson-Moss). The form of "guidance" most needed from the FTC is more *doctrinal*: how does the FTC apply the various prongs of unfairness and deception?

8. **You testified that "[t]he most important, most welfare-enhancing reform the FTC could undertake is to better incorporate sound economic- and evidence-based analysis." In what arenas does the FTC fail to do this? Why is it so important in your view? Conversely, what is the harm by not incorporating economic- or evidence-based analysis?**

Consumer protection is one particular arena where the FTC repeatedly fails to sufficiently incorporate sound economics into its analysis and develop an adequate evidentiary base. This failure is critically important because, in many cases, new and innovative business practices that appear on their face to harm consumer welfare — and thus require the FTC to step in under the guise of consumer protection — actually, on net, are either neutral or beneficial to consumer welfare, particularly when considered in the aggregate and over the long run. By failing to rigorously examine the economic and other evidentiary bases in its consumer protection analyses, the FTC risks not only wrongfully condemning consumer welfare-enhancing behavior, but also chilling innovations and new business practices that firms might otherwise experiment with in the future, thereby depriving consumers of whatever consumer welfare gains that might flow therefrom.

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http://www.ftc.gov/sites/default/files/documents/public_statements/statement-commissioner-joshua-d.wright/130619umcpolicystatement.pdf.

9. You quoted Commissioner Wright in saying that he "weigh[s] evidence relative to the burdens of proof and production." Can you explain why this is important? How can we formalize this?

The Bureau of Consumer Protection should act more like the Bureau of Competition when weighing evidence of consumer harm. On the competition side, antitrust law and economics have long recognized that there is value to many business arrangements previously thought to be anticompetitive. Efficiencies from things like tying arrangements, vertical integration, group boycotts, etc. can often be passed on to consumers and be beneficial on net. The Antitrust Guidelines issued by the FTC and DOJ clearly reflect the agencies' ongoing dialogue with the economics profession, both indirectly, through litigation (where economists play a key role as expert witnesses) and directly, through, among other things, FTC workshops featuring economists and the FTC's own Bureau of Economics.

Unfortunately, the FTC's Bureau of Consumer Protection has failed to integrate economic analysis into its work, with scant exceptions, such as calculating damages in certain areas. At least from the outside, it does not appear that the Bureau of Consumer Protection is taking advantage of the Bureau of Economics' expertise, or of economics more generally, to guide its enforcement actions — and ensure that it prioritizes its limited resources on actions that will do the most good for consumers.

In fact, the "countervailing benefits" prong of the Unfairness Policy Statement that was enshrined in statute (15 U.S.C. § 45(n)) mandates a cost-benefit analysis. In other words, cost-benefit analysis is already supposedly formalized, but the FTC rarely follows through in sharing this analysis in its complaints.

10. I realize I'm asking an economist this question, but can you imagine a scenario where it would ever be appropriate to not consider economic analysis?

There may be certain occasions where economic analysis can be more abbreviated, such as when public policy has long dealt with a practice and has determined it is nearly always harmful. The Unfairness Policy Statement allows the FTC to consider long-established public policy when evaluating "substantial injury." In 1994 Congress added Section 5(n) to the FTC Act, providing that the FTC "may consider established public policies as evidence to be considered with all other evidence" but adding a limitation: "Such public policy considerations may not serve as a primary basis for such determination." This essentially means that, the FTC can abbreviate its Section 5 analysis *somewhat* for conduct that contravenes clearly established public policy. For instance, conduct that would amount to a tort, like intrusion upon seclusion, could also be a cognizable harm under Section 5 Unfairness, with less need for the FTC to do an extended economic analysis before condemning it. But such cases would likely be relatively rare. The Bureau of Competition has developed a deep (if not perfect or consistent) institutional appreciation of the error cost framework. The Bureau of Consumer Protection must do so as well.

11. You highlight that Section 5's "unfair acts or practices" prong is balanced by consideration of whether an injury is "outweighed by countervailing benefits to consumers or competition." How would you grade the Commission on its consideration of that limitation in enforcement actions in recent years?

This requirement, which amounts to cost-benefit analysis, was essential to the *quid pro quo* by which Congress allowed the FTC to retain its unfairness authority — and yet the FTC just isn't taking it seriously.

Everyone remembers that in math class growing up, even getting the right answer without showing our work would not result in full points on a test. In its enforcement actions, the Commission has consistently failed to consider the countervailing benefits prong in any meaningful way (*see, e.g.*, *Apple*, *Amazon*), so they would have to be graded quite poorly in that respect. If the FTC wants businesses to have sufficient notice from Section 5 complaints, much more needs to be said in the complaints than the threadbare conclusions of law that are currently common. More effective use of no-action letters and more formal legal guidance (rather than the vague business brochures currently in vogue) would help, but ultimately, the only way to get the FTC to develop its unfairness doctrines in anything like the rigorous way it has developed its antitrust doctrines is to reform the FTC's structure and approaches to encourage at least *some* litigation over substantive questions.

12. Is it appropriate for the FTC to issue 20 year consent agreements in every case, or to apply the same conditions in very different cases? Or should the FTC craft remedies that are commensurate to the conduct at issue? Would anyone else like to comment?

No, it is inappropriate for the FTC to issue 20 year consent decrees in every case, particularly in high-tech areas like data security and online consumer protection. These areas are evolving so rapidly that far-reaching consent decrees — while appropriate in the near-to-medium term — may prove to be unreasonably burdensome and ineffectual in the long term, either putting the consenting parties at a competitive disadvantage or forcing them to have to go back to the FTC to seek modification of a consent decree before it has run its course. Thus, while 20 year consent decrees may be appropriate in *some* cases, they certainly are not appropriate in *every* case, and applying the same sort of conditions in very different cases may result in very disproportionate and inequitable outcomes for regulated parties. Ideally, the FTC should craft remedies in each case that are commensurate to the conduct at issue and the nature of the particular industry at hand.

At a minimum, the FTC should issue guidelines on consumer protection consent decrees explaining its approach in a systematic way. But the fact that the FTC had such guidelines on disgorgement remedies in competition cases and then summarily revoked them, without any

further process or public discussion,[8] suggests that that the FTC — or at least, this Chairman — is deeply resistant to constraints upon its/her discretion, whatever the value of those constraints. Accordingly, Congress may need to legislate in this area — or at least begin by requiring the FTC either to issue such guidelines or to explain, in a meaningful way, why they are not necessary.

13. The FTC's draft strategic plan, released last summer, says nothing about the role of economics or the Bureau of Economics. What should it have said?

The plan should have said much more about the role of economics, in general, and the Bureau of Economics, in particular. The Bureau of Economics is one of the most important tools for the FTC to ensure its rules and enforcement actions promote consumer welfare — and that it prioritizes its limited enforcement resources on the greatest harm to consumers. The FTC should use cost-benefit analysis and empirical scholarship rather than relying on anecdotes and speculation about consumer harm from ambiguous conduct.

For instance, in *Amazon*, the FTC seemingly failed to compare the benefits from one-click buying, even for in-app purchases, to the harms. The Bureau of Consumer Protection chose to cherry-pick anecdotes instead of engage in the type of economic analysis the Bureau of Economics is well-positioned to make. It is quite possible that the benefits from this feature (more specifically, from the particular way it was designed) for the vast majority of consumers greatly outweigh the harms to a few users. A serious analysis of transaction costs would likely suggest that the "least cost avoider" (an essential concept in any economic analysis of regulation) in such a case is the parents who could have reasonably avoided the costs by better monitoring of their devices, rather than Amazon.

14. Congress and the FTC spent a lot of time working out the standards for deception and unfairness. What are the limitations on an agency's authority if it can push the law in new directions without a court ever weighing in to make sure they're appropriately applying their legal mandate?

Since the FTC's 1980 showdown with Congress, the FTC has effectively evaded judicial review of its Section 5 enforcement actions –until the recent challenges by Wyndham and LabMD. This appears to reflect the tremendous pressure the FTC can put on defendants to settle. The FTC's Part III administrative litigation process gives Bureau staff free rein to drag investigation targets through a very expensive discovery process, in which targets have few procedural rights, before ever getting the full Commission to agree to filing an administrative complaint. Once the Commission decides to pursue a case, unless it chooses to file suit directly in Federal court, the target faces a long and costly internal process: trial before an

[8] FTC, *FTC Withdraws Agency's Policy Statement on Monetary Remedies in Competition Cases; Will Rely on Existing Law* (July 31, 2012), *available at* http://www.ftc.gov/news-events/press-releases/2012/07/ftc-withdraws-agencys-policy-statement-monetary-remedies.

ALJ and then appeal to the FTC, where they will almost always lose (since the FTC brought the complaint in the first place). Each loss could impose significant damage on the company's public image, which may be its most valuable asset. Under these circumstances, it is hardly surprising that rational defendants will agree to settle, even in cases of ambiguous conduct or uncertain law.

The problem with this scenario is that it allows the FTC to assert novel legal theories of unfairness and deception without judicial review — and that this pattern can, apparently, persist indefinitely. The *Wyndham* and *LabMD* cases have already highlighted the process failures behind the FTC's current enforcement regime, but Congress should not wait for the FTC to address these process failures. Congress should begin drafting FTC process reform legislation aimed at ensuring that the FTC does not violate the spirit of the 1980 and 1983 Policy Statements and the 1994 amendments to the FTC Act through the loophole of adjudicated consent decrees.

15. Do you believe the FTC is using its workshops properly? Are they really helping to inform the agency and prioritize its limited enforcement resources? Or are they being used as informal rulemakings to circumvent the Magnuson-Moss process by producing recommendations like "privacy by design" that, while technically non-binding, the FTC then treats as legal requirements or imposes in consent decrees?

Unfortunately, the FTC has repeatedly failed to use its workshops properly, as they often adduce little information about how the agency will prioritize its limited enforcement resources. Paramount among those considerations ought to be how the FTC will use its statutory authority to achieve optimal regulatory outcomes, but, as was the case with the FTC's Internet of Things workshop, for example, the FTC simply failed to ask such basic questions when it solicited public comment ahead of the workshop.[9] Instead, the FTC is using its workshops as a *de facto* rulemaking process for unfairness and deception in many areas. Where once workshops reports were simply descriptive accounts of what was discussed, they often now take the form of prescriptive quasi-rules that regulated parties must abide by or risk having enforcement actions brought against them. Not only is this is a poor use of agency resources, it also fails to provide for fair notice and effectively evades Congressionally-designed requirements for FTC rulemaking.

For instance, in *LabMD*, the FTC claims that it was an unfair trade practice for LabMD not to have done more than it did to keep peer-to-peer file sharing software off its computers — and rests its case, in significant part, on a 2004 staff report on the subject of peer-to-peer file sharing.[10] That report summarizes an FTC workshop at which one technologist mentioned

[9] *See* FTC, *FTC Seeks Input on Privacy and Security Implications of Internet of Things* (Apr. 17, 2013), *available at* http://www.ftc.gov/news-events/press-releases/2013/04/ftc-seeks-input-privacy-and-security-implications-internet-things.

[10] *See* FTC, *In re LabMD, Inc.*, Docket No. 9357, COMPLAINT (Aug. 28, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/cases/2013/08/130829labmdpart3.pdf.

the potential risk that such software could cause. The FTC seems to believe this report, issued without notice and comment (let alone the other requirements of Magnuson-Moss) created a legal duty.[11]

In *Wyndham*, the FTC similarly pointed to brochures produced by workshops as part of fair notice to businesses — despite the fact that these brochures are not binding law. Relatedly, the FTC has pointed to previous complaints and consent decrees as further notice to businesses. Legally, consent decrees are simply contracts, binding only upon the parties involved. Even more importantly, neither the workshops, brochures, complaints, nor the consent decrees actually explain how Section 5's factors apply to real world facts in a way that would allow a business to understand the subtle evolution of doctrine — and use that understanding of doctrine to predict the law in advance, and to adjust their conduct accordingly. At most, a business could discern what specific things the FTC found to constitute violations of Section 5 in the past; but it could not know with any certainty what is within the law prospectively.

Congress created Magnuson-Moss for a reason: the FTC of the 1970s had effectively untethered itself from Section 5. If the courts allow the FTC to continue down this road, then the agency will again become essentially a second national legislature.

16. In unfairness cases like the one previously pursued against Apple regarding in-app purchases, the FTC seems to aggregate diffuse harms on one side of the equation but does not consider the diffuse costs of their requirements, like time spent dealing with extra disclosures. Is the FTC stacking the deck? Could this be considered arbitrary and capricious if it ever wound up before a court?

Indeed, particularly when it comes to unfairness cases like those regarding in-app purchases by Apple and Amazon, the FTC is stacking the deck in its favor. Not only does it aggregate diffuse costs while ignoring the costs that enforcement action would impose on regulated parties, but it ignores the aggregate benefits to many users who likely enjoyed the great ease of in-app purchases. The idea that parents were not able to monitor their children's device use, but will be able to navigate the legalistic disclosures required for express consent seems contradictory, yet this is just another example of the FTC failing to consider the countervailing benefits and reasonable avoidance prongs of Section 5 unfairness.

On the legal prospects, it is certainly possible that the FTC's current approach could face a legal challenge and have one of their enforcement actions found arbitrary and capricious in court as a violation of the Administrative Procedure Act.[12] Indeed, a court may even find the

[11] *See* FTC, *FTC Issues Report on Peer-to-Peer File Sharing* (June 23, 2005), *available at* http://www.ftc.gov/news-events/press-releases/2005/06/ftc-issues-report-peer-peer-file-sharing.

[12] 5 U.S.C. § 706(2)(A) (2012) ("[A] reviewing court shall—hold unlawful and set aside agency action, findings, and conclusions found to be—arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law[.]").

FTC has failed to produce sufficient evidence to satisfy the elements of Section 5 in the *Wyndham* or *LabMD* cases.[13] Thus, rather than leave it to the often unpredictable judiciary, the FTC should take the time to reform its processes now before a court forces it to.

[13] *See* FTC v. Wyndham Worldwide Corp., D.N.J., No. 2:13-cv-01887; LabMD, Inc. v. FTC, U.S. Dist. Ct. N.D. Georgia, Atlanta Div., No. 1:14-cv-00810-WSD.